

**Minutes of the Meeting of the
Board of University and School Lands
June 29, 2017**

The June 29, 2017 meeting of the Board of University and School Lands was called to order at 9:01 AM in the Governor's Conference of the State Capitol by Chairman Doug Burgum.

Members Present:

Doug Burgum	Governor
Alvin A. Jaeger	Secretary of State
Wayne Stenehjem	Attorney General
Kelly Schmidt	State Treasurer
Kirsten Baesler	Superintendent of Public Instruction – Via Telephone

Department of Trust Lands Personnel present:

Lance D. Gaebe	Commissioner
Linda Fisher	Deputy Commissioner
Mike Humann	Director, Surface Division
Taylor Lee	Director, Revenue Compliance
Kristie McCusker	Legal Assistant
Catelin Newell	Office Manager

Guests in Attendance:

Cassandra Torstenson	Governor's Staff
David Garner	Office of the Attorney General
Paul Forster	Crowley Fleck PLLP
Ron Ness	North Dakota Petroleum Council
Brent Bogar	Jadestone Consulting
Daniel Kelly	McKenzie County Healthcare Systems
Wade Burns	Beaver Creek Archaeology for Continental Resources
Leslie Bakken Oliver	Governor's Legal Counsel
Geoff Simon	Western Dakota Energy Association
Amy Dalrymple	Bismarck Tribune
John Hageman	Fargo Forum

APPROVAL OF MINUTES

A motion to approve the minutes of the May 25, 2017 meeting was made by Treasurer Kelly Schmidt and seconded by Attorney General Wayne Stenehjem and the motion carried unanimously on a voice vote.

ENERGY INFRASTRUCTURE AND IMPACT OFFICE

Nursing Home and Home Health Grant Recommendations

House Bill 1176 approved in 2015, allocated up to \$4 million for nursing home and basic care facilities and home health care firms. In April 2017 the Board approved grant consideration of \$2 million for nursing homes, basic care facilities, home health care and hospice care firms. The 2015 legislation specifies up to \$500,000 be distributed to home health/hospice programs in Williston and Dickinson. While statute specifies oil and gas impact grant funds are only for political subdivisions, HB 1176 provided exemptions for this grant area. There is \$1,750,000 available for nursing homes and basic care facilities in oil producing counties and \$250,000 for home health care and hospice programs in Williston and Dickinson.

The Board had previously appointed the following advisory committee members:

Amy Kreidt	St. Lukes Home, Dickinson
Jon Frantsfog	St. Benedict's, Dickinson
Dan Kelly	McKenzie County Healthcare, Watford City
Shelly Peterson	North Dakota Long Term Care Association
Randy Pederson	Tioga Medical Center, Tioga
Sue Heitkamp	CHI Health at Home
Kurt Stoner	Bethel Lutheran Home, Williston

The advisory committee met in January 2016 to establish guidelines for a two-fold grant program:

- 1) 30% of the unreimbursed costs based on the 2014 audited financial reports published in 2015, with a maximum of \$150,000 to any one facility; and
- 2) Up to \$40,000 per facility, (if the facilities do not reach \$150,000 in the first factor) through a competitive round evaluating impact based on eight established factors:
 - a. Operated at a loss in either portion of facilities considered during the last two fiscal year ends;
 - b. Has stopped or limited admissions due to staffing shortages;
 - c. Has high reliance on contracted staffing;
 - d. Exceeds the direct care, other direct or indirect care limits, for nursing facilities or is a basic care facility and exceeds the direct and indirect limits;
 - e. Has limited access to affordable housing;
 - f. Has limited access to affordable childcare services;
 - g. Has served, as part of its operations, the low-income Medicaid population; or
 - h. Has seen a reduction in days of services due to changes in population.
- 3) No facility exceeds \$150,000 when combining both portions of the grant funding,
- 4) Adopted a goal that any remaining funds not already committed in items 1 and 2 would be added to the nursing facilities formula grant distribution.

In 2016, due to a shortfall in the Oil and Gas Impact Grant fund, the Board was forced to suspend consideration of nursing home and home health care grants. However, in March 2017, the Board was able to announce the availability of up to \$2 million for grants.

In April 2017 the advisory committee increased eligibility of unreimbursed costs from 30% to 40% and increased the competitive round funding cap from \$40,000 to \$50,000. Each facility's total eligibility was capped at \$150,000. The scoring criteria remained unchanged. The advisory committee also chose to utilize 2014 audited financials for the applications.

Of the 27 facilities eligible for consideration, 17 organizations submitted applications for grant funding. Applications were scored by advisory committee.

Based upon the criteria, scoring in the published grant announcement, the Director made the following recommendations:

CHART A Energy Infrastructure and Impact Office (EIO) Director Recommendation							
Applicant	City	Project	App#	Requested	40% of Unreimbursed Costs	Competitive Round	Recommend
Northwest Hospital Tax District	Crosby	Unreimbursed Costs	A170060	\$150,000.00	\$150,000.00	\$0.00	\$150,000.00
Trinity Homes	Minot	Unreimbursed Costs	A170061	\$150,000.00	\$150,000.00	\$0.00	\$150,000.00
Mountrail Bethel Home	Stanley	Unreimbursed Costs	A170062	\$150,000.00	\$150,000.00	\$0.00	\$150,000.00
Souris Valley Care Center	Velva	Unreimbursed Costs	A170063	\$66,075.00	\$8,425.00	\$29,000.00	\$37,425.00
Lakeside Community Living Center	New Town	Unreimbursed Costs	A170064	\$30,000.00	\$0.00	\$25,000.00	\$25,000.00
St. Luke's Home	Dickinson	Unreimbursed Costs	A170065	\$109,726.00	\$59,726.00	\$39,000.00	\$98,726.00
Richardton Health Center	Richardton	Unreimbursed Costs	A170066	\$150,000.00	\$0.00	\$23,000.00	\$23,000.00
Hill Top Home Of Comfort	Killdeer	Unreimbursed Costs	A170067	\$50,000.00	\$23,786.00	\$33,000.00	\$56,786.00
Tioga Medical Center Long Term Care	Tioga	Unreimbursed Costs	A170068	\$50,000.00	\$0.00	\$31,000.00	\$31,000.00
McKenzie County Health Care Systems	Watford City	Unreimbursed Costs	A170069	\$150,000.00	\$150,000.00	\$0.00	\$150,000.00
Bethel Lutheran Nursing & Rehab Center	Williston	Unreimbursed Costs	A170070	\$61,169.00	\$61,169.00	\$41,000.00	\$102,169.00
St. Benedict's Health Center	Dickinson	Unreimbursed Costs	A170071	\$73,820.00	\$28,528.00	\$40,000.00	\$68,528.00
Bethel Lutheran Nursing & Rehab Center	Williston	Unreimbursed Costs	A170072	\$50,000.00	\$0.00	\$39,000.00	\$39,000.00
Southwest Healthcare Services-	Bowman	Unreimbursed Costs	A170073	\$150,000.00	\$150,000.00	\$0.00	\$150,000.00
Benedictine Living Center Of Garrison	Garrison	Unrecovered Costs	A170076	\$50,000.00	\$0.00	\$31,000.00	\$31,000.00
CHI Health At Home Williston	Williston	Unreimbursed Costs	A170074	\$125,000.00	\$0.00	\$0.00	\$125,000.00
CHI Health At Home-Dickinson	Dickinson	Unreimbursed Costs	A170075	\$125,000.00	\$0.00	\$0.00	\$125,000.00
				\$1,690,790.00	\$931,634.00	\$331,000.00	\$1,512,634.00

On June 13, 2017, the advisory committee met to evaluate and review applications. The committee sought to adjust the criteria for unreimbursed costs from 40% to 70% and increase the facility cap from \$150,000 to \$200,000. The committee also sought to increase each facility's eligibility by an additional \$10,000 to reach the \$2 million previously authorized by the Board.

The Board reviewed the alternate recommendation offered by the advisory committee.

The EIO Director recommended that the Board award grants in accord with announced criteria and caps, including the 40% of unreimbursed costs factor based on facilities' 2014 audited financial reports, and \$150,000 per facility award cap.

Motion: The Board authorized grants totaling \$1,512,634 to the 17 nursing home and home health care grant applicants, as depicted on Chart A. The grants are provided to support financial losses due to oil and gas development activities. In addition, a second grant round should be held for the remainder of the \$2 million allocated to nursing homes and basic care facilities.

Action Record	Motion	Second	Aye	Nay	Absent
Secretary Jaeger			X		
Superintendent Baesler			X		
Treasurer Schmidt	x		X		
Attorney General Stenehjem		x	X		
Governor Burgum			X		

City of Ross Grant Extension Request

In 2013 the City of Ross applied for a \$2.5 million Energy Impact grant for lagoon repair and expansion. The Board's advisory committee recommended a \$1 million toward repairs to the structure, which the Board awarded in 2014. This grant's deadline was August 31, 2017. The city requested an extension to Grant G150012 until December 31, 2019.

In May 2017, the Board did not act on a grant extension request and requested more background information on the project status, which the city provided and the Board reviewed.

The lagoon is in poor condition and its function was challenged by the dramatic population increase in 2013. The State Health Department and the city's engineer indicate that embankment failure is plausible. If the city does not repair the lagoon it may need to be condemned, which could force the local citizens to build a new system or to install individual septic systems.

Motion: The Board extended the deadline of Grant G150012 – City of Ross Wastewater Treatment Facility to December 31, 2019 in order for it to make necessary repairs to its waste water lagoon.

Action Record	Motion	Second	Aye	Nay	Absent
Secretary Jaeger	X		X		
Superintendent Baesler			X		
Treasurer Schmidt			X		
Attorney General Stenehjem		X	X		
Governor Burgum			X		

Proposed Remaining Grant Priority Plan

The Oil and Gas Impact Grant Fund has \$16,177,559 in available grant monies, which consists of the unawarded balance of \$17,638,559 minus the allocations made by the 2017 Legislature: \$261,000 for a Developmentally Disabled Service Provider, \$700,000 for combating the effects of Human Trafficking, and \$500,000 reserved for SAVIN (Statewide Automated Victim Information & Notification) programming.

June's deposit of \$4,985,370 is above the six-month average deposit of \$3.8 million and is included in the amounts above. Two anticipated deposits to the Oil and Gas Impact Grant Fund remain for the 2015-2017 biennium.

Remaining Legislative earmarks for future consideration by the Board include:

- 1) Developmentally Disabled Service Provider - \$261,000 (HB 1015 - 2017 Legislative Session);
- 2) Human Trafficking - \$700,000 (SB 2203 - 2017 Legislative Session);
- 3) SAVIN funding –\$500,000 “reserved” (HB 1003 - 2017 Legislative Session);
- 4) K-12 school districts – up to \$15 million (HB 1176 - 2015 Legislative Session);
- 5) Bowman and Divide Counties – up to \$8 million - Legislation states that an equal amount of funds must be awarded to the two counties (HB 1176 - 2015 Legislative Session);
- 6) Up to \$48 million to airports (HB 1176 - 2015 Legislative Session);
 - a. \$39 million remains for the Williston Airport (SB 2015 - 2015 Legislative Session)
 - b. \$4.6 million remains for the Dickinson Airport (SB 2015 - 2015 Legislative Session)
 - c. up to \$1.4 million remains unspecified for other airports; and
- 7) Eligible General (seven counties with lower oil production than primary Bakken area) - up to \$5 million (HB 1176 - 2015 Legislative Session).

The 2017 Legislature allocated \$35 million to the Williston airport and \$5 million to the Dickinson airport presumably to address the amounts it reserved for those entities in 2015 because it anticipated would not be funded because of the revenue shortfall.

The Director reviewed whether the Board has discretion to elect to not award grants if sufficient Oil and Gas Impact Grant funds are available.

The specific statute on grant distribution was presented:

The moneys accumulated in the oil and gas impact grant fund **must be allocated as provided by law and as appropriated by the legislative assembly for distribution through grants by the energy infrastructure and impact office** to oil and gas development-impacted cities, counties, school districts, and other taxing districts or for industrial commission enforcement of laws and rules relating to geophysical exploration in this state. N.D.C.C. § 57-62-03.1. (Emphasis added).

Section 10 of the 2017 Legislature's Senate Bill 2013 indicates that funds not distributed during the 2015-2017 biennium are carried forward to the next biennium. The section references Chapter 463 of the 2015 Session Law (HB 1176) which contained most targeted grant areas. Thus the Legislature presumably intended these allocations to be made:

SECTION 10. EXEMPTION - OIL AND GAS IMPACT GRANT FUND. The amount appropriated from the oil and gas impact grant fund for the energy infrastructure and impact office line item in section 1 of chapter 13 of the 2015 Session Laws and for oil and gas impact grants in section 5 of chapter 463 of the 2015 Session Laws is not subject to section 54-44.1-11. Any money deposited in the fund for taxable events occurring through June 30, 2017, and any unexpended funds from the appropriation are available for grants and administrative costs associated with the fund during the biennium beginning July 1, 2017, and ending June 30, 2019.

The Director concluded that the Board does not have the discretion to withhold funds from grant areas that were previously identified by the legislature. Based on previous legal guidance received on the short-fall of funds, the Board may grant less than the appropriated amounts in discretionary areas, but it is unlikely the Board can choose to not award grants if sufficient resources are available.

Proposed Plan for Remaining 2015-2017 Grants:

The Western Dakota Energy Association advocated a partially prorated distribution of the remaining expected grant funds instead of fully funding only certain 2015 legislative allocations. A letter from the association was reviewed.

The Energy Impact Office Director recommended the Board target 95% funding the remaining grant areas and inform the applicants of the goal so they could proceed with construction or building projects pending the Board's formal awarding of grants.

- 1) K-12 School Districts – The grants are determined based on the ratio of oil and gas gross production tax distribution payments made to school districts in fiscal year 2014. The funds are to be used for renovation and improvement projects.

Inform eligible schools to anticipate 95% funding for the remaining \$15 million allocation. The districts can initiate needed repairs or upgrades in anticipation of final grants in the fall.

- 2) Bowman and Divide Counties –
Communicate with both counties to plan for a split of \$7.6 million (95%) so each can implement construction season repairs or upgrades.
- 3) Other Airports –
Inform the Aeronautics Commission, which has served as the advisory committee for airport grants, to anticipate up to \$1.33 million (95%) available for energy development impacted municipal airports, request it adopt guidelines for a grant announcement.
- 4) Seven Counties (General) – refers to the counties, cities, organized townships, or other taxing districts within seven counties that individually received less than \$5 million of gross production tax distributions in fiscal year 2014, include: Golden Valley, McHenry, Renville, McLean, Mercer, Slope, and Ward.

Reactivate the advisory committee of local officials to adopt guidelines for a grant announcement of up to \$1 million for projects and needs related to current impacts from oil and gas development. Grants could be considered based upon available funds after the final biennial deposit in August.

- 5) No 2015-2017 biennium funds will be allocated to the Williston airport, no additional 2015-2017 biennium funds will be targeted to the Dickinson airport, nursing homes/home health care, or contingency requests.

2015-2017 Biennium Breakdown (Combining like FY Rounds)					
Round or Award	#Applications	Amt of Projects	Amt Requested	#Awards	Amount Awarded
Airports FY 2016	28	\$9,717,451	\$3,531,497	28	\$3,000,775
EMS FY 2016	43	\$9,859,855	\$7,467,128	32	\$3,684,898
K-12 FY 2016	62	\$15,000,193	\$15,000,193	62	\$14,988,201
Law Enforcement FY 2016	59	\$22,102,479	\$19,853,329	54	\$7,778,869
Fire Districts	67	\$22,745,202	\$16,837,094	36	\$3,000,000
Local District Health Units	3	\$2,000,000	\$2,000,000	3	\$2,000,000
Emergency Request FY 2016	1	\$1,300,000	\$1,100,000	1	\$500,000
Human Trafficking - FY 2016	6	\$1,207,510	\$1,207,510	6	\$750,000
Critical Access Hospitals	15	\$23,333,247	\$12,408,584	15	\$10,000,000
Providers to Developmental Disabled	22	\$2,000,000	\$2,000,000	22	\$2,000,000
Domestic Violence Shelters	2	\$5,823,654	\$2,000,000	2	\$1,987,682
Sexual Assault Examiner	10	\$309,733	\$309,733	7	\$250,000
City of Stanley	1	\$9,000,000	\$1,700,000	1	\$1,700,000
City of Kenmare	1	\$516,345	\$500,000	1	\$500,000
City of Berthold	1	\$400,000	\$200,000	1	\$200,000
City of Burlington	1	\$840,000	\$100,000	1	\$100,000
EMS FY 2017	30	\$6,598,101	\$4,211,575	28	\$2,315,102
Nursing Homes/Basic Care/Hospice	17	\$12,398,701	\$1,690,790	17	\$1,512,634
DD Provider - FY 2017					
Human Trafficking - FY 2017					
	369	\$145,152,471	\$92,117,433	317	\$56,268,160
2015-2017 Grant Adjustments					-\$684,869
Net Awards					\$55,583,291
Admin					\$700,000
As of: June 22, 2017					
2015-2017 Collected To Date	\$73,755,966				
Projected Revenue (at \$3.8m/mo)	\$7,600,000				
Administrative Costs (Thru Mar31)	534,116				
Expected Allocations	\$80,821,850				
Gross To Award Today:	\$17,638,559				
Net To Award Today:	\$16,177,559				
Unmet Allocations	\$59,178,150				
Remaining Allocations					
AG-SAVIN (Reserved) \$500,000					
Human Trafficking \$700,000					
DD Provider \$261,000					
K-12 Schools \$15,011,799					
Bowman/Divide Counties \$8,000,000					
Other Airports \$1,399,225					
Eligible General \$5,000,000					
Williston Airport \$39,000,000					
Dickinson Airport \$4,600,000					
Nursing Homes/Basic Care/Hospice \$2,000,000					
Contingency \$6,321,131					
Total =					\$82,793,155
Final Award Scenario	K-12 Schools @	95%	\$14,261,209		
	Bowman/Divide @	95%	\$7,600,000		
	Other Airports @	95%	\$1,329,263.75		
		Sub-total	\$23,190,473		
	Eligible General @	Remaining Amt	\$587,087		

Contingency Fund

Outside of the \$40 million of grants for the Dickinson and Williston airports, there is no general grant authorization in the 2017-2019 biennium. However, there is approximately \$2,115,537 from 2013-2015 biennium grants that were canceled or the balances which were retired during the current biennium. These funds have not been reallocated.

In accordance with Section 10 of Senate Bill 2013 (2017) which permits the use of unexpended funds to be available for grants and administrative costs, the Director proposes reserving this \$2.1 million for operations, salary and a small contingency for unknown and unanticipated needs over the next biennium.

Motion: The Board adopted the Energy Infrastructure and Impact Office grant funding plan highlighted in the preceding chart and it authorized the Director to inform recipients of the targeted grant amounts for the remaining 2015-2017 biennium legislative allocations; and to establish a contingency fund from prior biennia's unexpended funds for the EIO administrative costs and possible grants during the 2017-2019 biennium. The availability of funds should be communicated to oil producing counties.

Action Record	Motion	Second	Aye	Nay	Absent
Secretary Jaeger		X	X		
Superintendent Baesler			X		
Treasurer Schmidt	X		X		
Attorney General Stenehjem			X		
Governor Burgum			X		

SURFACE DIVISION

Proposed Foxtail Wind LLC Wind Farm (Dickey County: N2-36-131-66)

NextEra Energy Resources LLC (NextEra), headquartered in Juno Beach, Florida, applied for a wind energy easement agreement (easement) for its Foxtail Wind LLC, to place three wind towers within the tract described as N2-36-131-66 Dickey County, containing 320 acres more or less. The proposed Foxtail Wind Farm located southeast of Kulm, will contain approximately 65 wind towers and produce 150 megawatts of power.

Dickey County advised the Department that it defers to the North Dakota Public Service Commission (PSC) for zoning requirements. NextEra, on behalf of Foxtail Wind Farm, is in the process of submitting an application to the PSC for project approval.

The Department conducted an onsite inspection of the trust property, including the three proposed wind tower locations, associated access road, collection lines and construction crane access paths. Wind tower locations have been sited in coordination with the Department to maximize the number of wind towers and minimize environmental interference on trust land. The Board reviewed a map of the proposed Foxtail Wind Farm area.

NextEra was informed an easement will not be approved until the project receives PSC approval and the Board has considered the easement terms.

NextEra has asked for confirmation that the Board will consider an easement for the Foxtail Wind Farm should the wind farm be approved by the PSC. NextEra requested a letter to provide to the PSC to document Board interest. If the PSC approves the project, the Department would negotiate proposed easement terms with NextEra and present a draft easement agreement to the Board for its consideration.

Motion: The Commissioner is authorized to confirm by letter that the Board will consider a Wind Energy Easement Agreement with Foxtail Wind LLC regarding the location and potential use of trust land within the Foxtail Wind Farm; and upon the Public Service Commission's approval of the project, the Commissioner is authorized to negotiate and submit a recommended easement and terms for Board consideration.

Action Record	Motion	Second	Aye	Nay	Absent
Secretary Jaeger	X		X		
Superintendent Baesler			X		
Treasurer Schmidt			X		
Attorney General Stenehjem		X	X		
Governor Burgum			X		

MINERALS MANAGEMENT

Calculation of Royalty Based on Gross Proceeds

The Board is a trustee in managing land, minerals and proceeds derived on behalf of permanent trust funds for the exclusive benefit of specific beneficiaries. It also manages sovereign minerals for the State. Over the course of its history, the Board has entered into oil and gas leases under the terms and conditions contained in its standard lease (“Board’s Lease”), which is used for both trust and sovereign minerals. The current version of the Board’s Lease has been in effect since the late 1970s following the adoption of rules modifying its terms. By its current terms, the Board’s Lease includes formally adopted Oil and Gas Rules in Chapter 85-06-06.

At its March 30, 2017 meeting, the Board reviewed a letter (“Deduction Letter”) regarding deduction of costs from gas royalty payments, that the Department intended to send to the Board’s oil and gas operators. The purpose of the Deduction Letter was to reiterate the Board’s procedure of calculating gas royalties in an arm’s length transaction. The Deduction Letter included a detailed legal analysis of the relevant terms of the Board’s Lease. It did not change the Board’s policy, but rather was a reminder of the responsibility in calculating and submitting gas royalties according to the Board’s Lease.

The Board’s Lease requires gas royalties to be calculated based on gross production or the market value thereof, at the option of the lessor, such value to be based on the gross proceeds of sale where such sale constitutes an arm’s length transaction. Correspondingly, oil royalties are based on the greater of: 1) the highest posted price, plus premium, if any, paid for oil, condensate, distillate, or other liquid hydrocarbons, respectively, of a like type and gravity for the field where produced and when run, or 2) the highest market price thereof paid for the area where produced and when run, or 3) the gross proceeds of sale.

Under these royalty provisions, the lessee may not reduce royalty payments for expenses it has incurred prior to the sale.

In advance of the Commissioner sending the Deduction Letter, the Board asked for legal comments from industry representatives regarding the issues the Deduction Letter addressed. Two responses were received from the North Dakota Petroleum Council (NDPC).

History

Earlier versions of the Board’s Lease allowed for deductions for expenses. Specifically, it required oil royalties be paid free of cost to the pipeline, and gas royalties be based on the gas produced at the mouth of the well based on the prevailing market rate.

The minutes from a special Board meeting on April 12, 1979 indicate that the Board rejected one operator’s interpretation that the State was entitled to royalties on the market price of gas only “at the well” and that all costs of readying the gas for sale, from the well to the point of sale after processing, are deductible. In response to this interpretation, the Board removed the words “at the well” from the gas royalty provision of its lease.

In 1979, the Board apparently requested comments on its proposal to revise the royalty provisions of the lease to include payment based on gross proceeds of sale for both oil and gas.¹ Of the comments the Board received, several letters did not mention concerns with oil and gas royalties based on the gross proceeds of sale. However, a number of responses directly noted the ramifications of requiring royalties be calculated based on the gross proceeds of sale. A common concern was that under this type of royalty provision, the Board was prohibiting lessees from

¹Gross proceeds of sale is the basis for calculating oil royalty payments if it is the highest of three values.

deducting certain costs from royalty payments. The Board reviewed a May 29, 1979 letter from Shell Oil Company (Shell) to the State Land Department which states: “that payment to the lessor is to be made at the greater of gross proceeds or the highest market price in the area. This is unfair to the lessee, as it ignores the business reality that gas, oil and hydrocarbon products are normally sold by contract, and that the income available for payment derives from the income received.”

Notwithstanding Shell’s and other opposition to the then proposed gross proceeds provision of its oil and gas lease and rules, the Board clearly intended to include this as the basis for calculating royalties. Some of Shell’s and other recommendations were incorporated, but the basis for calculating royalty payments on the highest of three values, including gross proceeds, was adopted and remains part of the Board’s Lease.

With regard to the adoption of rules and regulations concerning oil and gas leasing, the August 30, 1979 Board minutes state “[t]he royalty provisions now specify that gas royalties must be payable on the gross proceeds of sale made at arm’s length where neither party has a great advantage over the other. This assures a fair return to the State without total reliance on a nebulous fair market value test. Given the stage of oil development in North Dakota at the present time, North Dakota now has a good lease and rules.”

The terms of this gas royalty provision as they now exist were revised following these 1979 meetings and have remained in effect. The Board has maintained its position that the royalty provision in its lease prohibits deductions. In a September 9, 1980 Brief of Amicus Curiae filed by the Board in *West v. Alpar Resources, Inc.*, the Board acknowledged that if the lease at issue was construed as a “gross proceeds” lease, the lessee would have no right to deduct processing costs. In that case, the lease included a provision requiring royalties to be paid on the “proceeds” of the sale of the gas.

More recently, Assistant Attorney General Christopher Harvey noted in an October 27, 2014 letter to Denbury Resources, Inc. that based on the gross proceeds clause of the Board’s Lease, the Department is entitled to a royalty based on the gross contract price at that point of sale. To deduct transportation expenses before calculating the royalty would transform the lease into a “net proceeds” lease rather than a “gross proceeds” lease.

From 2012 to 2015, the Department sent over 40 notices to operators for taking deductions from the royalty payments reported on royalty reports. On behalf of the Board, the Department has consistently directed operators that deductions from royalty payments are not allowed.

Current status

The Deduction Letter is neither a change in the Department’s interpretation of the Board’s Lease nor a proposal of a new policy. The Deduction Letter was prepared to clarify the gas royalty provisions in the Board’s Lease and provide analysis of applicable case law. Its drafting was necessitated by recent Department oil and gas audits which found some operators improperly calculating gas royalties due under the Board’s Lease.

The legal comments that the Board received from the NDPC have been considered by the Commissioner and reviewed by the Board’s attorneys. While the comments suggest otherwise, the Board’s interpretation of the gross proceeds provision relating to the payment of gas royalties under its lease is not a change in policy.

Furthermore, the letters from the NDPC state that the legal analysis in the Deduction Letter does not support the Board’s interpretation of its lease. The Department disagrees.

The NDPC makes two main arguments in support of its position. First, it argues the Eighth Circuit’s decision in *Sondrol v. Placid Oil Co.*, 23 F.3d 1341 (8th Cir. 1994), does not support the Board’s

interpretation of its royalty provision. *Sondrol*, however, involved a situation where the lessor was to receive a royalty based on the proceeds the lessee received at the wellhead. As the Board's Lease requires royalties to be based on gross proceeds of sale regardless of the point of sale, *Sondrol* is not controlling. Second, the NDPC states that the North Dakota Supreme Court's decision in *West v. Alpar*, 298 N.W.2d 484 (N.D. 1980), is not controlling over the Board's Lease because it does not involve deductions in the context of an arm's length transaction. This argument is equally ineffective. The Board relies on *West* for its clear definition of the term "gross proceeds" which is the primary issue in interpreting the Board's royalty provision. The NDPC's argument concerning deductions of the midstream company that purchased the gas does not affect *West's* impact on interpretation of the Board's Lease.

Therefore, the Commissioner intends to distribute the Deduction Letter to 69 oil and gas operators which submit royalties and the approximate 900 associated lessees on whose behalf royalties are calculated and paid.

The March 8, 2017 Letter from the Office of the Attorney General to the Department relating to deduction of costs from gas royalty payments (Deduction Letter) was presented to the Board for its review.

EXECUTIVE SESSION

Motion: Under the authority of North Dakota Century Code Sections 44-04-19.1 and 44-04-19.2, the Board close the meeting to the public and go into executive session for purposes of attorney consultation to consult with the Board's attorneys on litigation related to royalty gas deduction.

Action Record	Motion	Second	Aye	Nay	Absent
Secretary Jaeger	X		X		
Superintendent Baesler			X		
Treasurer Schmidt			X		
Attorney General Stenehjem		X	X		
Governor Burgum			X		

At 10:17 AM the Board entered executive session for the purposes outlined in its adopted motion.

EXECUTIVE SESSION

Members Present:

Doug Burgum	Governor
Alvin A. Jaeger	Secretary of State
Wayne Stenehjem	Attorney General
Kelly Schmidt	State Treasurer
Kirsten Baesler	Superintendent of Public Instruction (via telephone until 10:25 AM)

Department of Trust Lands Personnel present:

Lance D. Gaebe	Commissioner
Linda Fisher	Deputy Commissioner
Mike Humann	Director, Surface Division
Taylor Lee	Director, Revenue Compliance
Kristie McCusker	Legal Assistant
Catelin Newell	Office Manager

Authorized Guests in Attendance:

David Garner	Office of the Attorney General
Leslie Bakken Oliver	Governor's Legal Counsel
Cassandra Torstenson	Governor's Staff

The executive session adjourned at 10:52 AM and the Board returned to open session and the public was invited to return to the meeting. During the executive session, the Board consulted with its attorney on legal strategy on royalty gas deductions and no formal action was taken.

O P E R A T I O N S

Office Staffing Update

The Department is recruiting for a Director of Revenue Compliance, with the anticipated departure of Taylor Lee, who has led the Division for 3 and 1/2 years. Mr. Lee is moving to join his wife who has taken a new job in Arizona.

The Revenue Compliance Division is responsible for all revenue accounting including royalty and lease receipts, surface lease receipts, unclaimed property receipts and other cash receipts pursuant to lease terms, state statutes, rules, and regulations. The Division implements and monitors internal controls, oversees compliance reviews of entities submitting payments to the Department, and is responsible for identifying payment discrepancies. The Director of Revenue Compliance supervises a four-person staff.

The Department is also preparing a job description and classification to recruit a Land Management Specialist to replace Michael Haupt who has announced his intended retirement after 30 years with the Department. Mr. Haupt, who has a background in range ecology and reclamation, has served as the primary point of contact for Board easements, right-of-way applications, and surface use requests.

The 2017 Legislature approved one full time equivalent position for a Geographic Information Systems (GIS) Specialist. This position description will be drafted and classified in hopes of hiring a qualified candidate to supplement the easement and reclamation tracking, minerals management and IT systems integration.

Administrative Rules Update

House Bill 1300, as adopted by the 2017 Legislature, removes the Board's established exemption from the Administrative Agencies Practice Act (N.D.C.C. Ch. 28-32). The bill's effective date is January 1, 2018.

North Dakota Century Code § 28-32-07 states: "Any rule change, including a creation, amendment, or repeal, made to implement a statutory change must be adopted and filed with the legislative council within nine months of the effective date of the statutory change."

The Department has initiated converting existing Board rules into the form and style of the North Dakota Administrative Code. The focus has been on the review, for possible adoption, of rules that affect the general public.

The goal is to secure some of the chapters for Administrative Rules Committee consideration in the last quarter of 2017. The plan is to submit proposed rules to Legislative Council for possible hearings in both November 2017 and February 2018.

Department is using the following as its guide:

- 1) North Dakota Century Code Ch. 28-32;
- 2) North Dakota Legislative Drafting Manual – 2017;
- 3) North Dakota Legislative Council Administrative Rules Drafting Manual – 2008;
- 4) Administrative Rules 2017 presentation – Vonette Richter, Legislative Council Code Reviser;
- 5) Office of Attorney General Administrative Rules Manual – 2016; and
- 6) Advice from the Board's Assistant Attorneys General.

North Dakota Century Code § 28-32-01(11) states:

"Rule" means the whole or a part of an agency statement of general applicability which implements or prescribes law or policy or the organization, procedure, or practice requirements of the agency. The term includes the adoption of new rules and the amendment, repeal, or suspension of an existing rule. The term does not include:

...

k. Any material, including a guideline, interpretive statement, statement of general policy, manual, brochure, or pamphlet, which is explanatory and not intended to have the force and effect of law.

The Department plans to submit rules seeking the effect of law for Board consideration from July through September 2017. Once approved by the Board, each chapter of proposed North Dakota Administrative Code Article 85 will be forwarded to the Office of Attorney General for review, published, considered in public hearings, and submitted to the Legislature's Administrative Rules Committee.

A flowchart of the Administrative Rules implementation process was presented to the Board.

Commissioner Search.

Secretary Al Jaeger shared an August 2015 Land Board memo related to the Commissioner Job Description. The memo depicted the changes in the scope of the commissioner's role between 2010 and 2015 and it indicated that the Board reviewed of the job responsibilities and to consider a salary adjustment in consideration of similar management positions within the state.

Governor Burgum indicated that the position will be posted within the next several weeks and he asked each member to appoint a representative to the commissioner search committee.

R E P O R T S

The Quarterly Financial Report (Unaudited) for Period Ended March 31, 2017 was presented to the Board.

Report of Easements Issued by Land Commissioner 5/15/17 to 6/15/17

Granted to:	WILLIAMS COUNTY HWY DEPT, WILLISTON-ND
For the Purpose of:	Easement: Road Right-of-Way
Right-of-Way Number:	RW0007573
Trust :	A – Common Schools
Legal Description:	WIL-159-102-36-NE4

Granted to:	WESTERN AREA WATER SUPPLY AUTHORITY, WILLISTON-ND
For the Purpose of:	Easement-Amend: Potable Water Pipeline
Right-of-Way Number:	RW0007898
Trust :	A – Common Schools
Legal Description:	WIL-156-100-16-NE4
Legal Description:	WIL-156-101-36-SW4
Legal Description:	WIL-156-99-16-NE4

<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>NORTHWEST COMMUNICATIONS COOP, RAY-ND Easement: Communication Cable - Buried RW0007921 A – Common Schools WIL-155-95-16-NW4, SW4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>NP RESOURCES LLC, DENVER-CO Easement-Amend: Directional Wellsite Location RW0007972 A – Common Schools GOL-143-103-36-NE4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description: Legal Description:</p>	<p>ARROW PIPELINE LLC, HOUSTON-TX Easement: Gas Transmission Pipeline RW0007973 A – Common Schools MCK-149-98-16-NE4, NW4, SE4 MCK-150-97-36-SE4, SW4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description: Legal Description:</p>	<p>ONEOK ROCKIES MIDSTREAM LLC, SIDNEY-MT Easement: Gas Gathering Pipeline RW0008001 A – Common Schools MCK-150-97-36-SE4, SW4 MCK-150-98-36-NE4, SE4, SW4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>WESTERN AREA WATER SUPPLY AUTHORITY, WILLISTON-ND Easement: Potable Water Pipeline RW0008015 A – Common Schools WIL-154-99-16-SE4, SW4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>TARGA BADLANDS LLC, HOUSTON-TX Easement: Gas Gathering Pipeline RW0008022 A – Common Schools MCK-151-96-36-NE4, SE4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>HESS NORTH DAKOTA PIPELINES LLC, MINOT-ND Easement: Drop Line-Multiple Pipelines & Communication Cable RW0008040 A – Common Schools MCK-151-96-36-SE4, SW4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>ONEOK ROCKIES MIDSTREAM LLC, SIDNEY-MT Easement: Drop Line-Gas Gathering Pipeline RW0008044 A – Common Schools MCK-150-97-36-SE4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>NORTHWEST COMMUNICATIONS COOP, RAY-ND Easement: Communication Cable - Buried RW0008046 A – Common Schools WIL-154-95-16-NE4</p>

<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>BNI COAL LTD, CENTER-ND Easement: Equipment Site RW0008052 A – Common Schools OLI-141-83-16-NE4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>BNI COAL LTD, CENTER-ND Permit: Coal Exploration RW0008053 A – Common Schools OLI-141-84-16-NE4, SE4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description: Legal Description:</p>	<p>BEK COMMUNICATIONS COOPERATIVE, STEELE-ND Easement: Communication Cable - Buried RW0008058 A – Common Schools OLI-141-81-16-NE4, SE4 LESS SCHOOL SITE OLI-141-82-16-NW4, SE4 WEST OF HWY AND SOUTH OF CNTY ROAD</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>NORTH DAKOTA PIPELINE COMPANY LLC, MINOT-ND Easement-Amend: Oil Transmission Pipeline RW0008060 A – Common Schools WIL-156-99-36-SE4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>NORTH DAKOTA PIPELINE COMPANY LLC, MINOT-ND Easement-Amend: Oil Transmission Pipeline RW0008061 A – Common Schools WIL-156-99-36-SE4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>MCKENZIE ELECTRIC COOPERATIVE INC, WATFORD CITY-ND Easement: Drop Line-Buried Electric Distribution Line RW0008074 A – Common Schools DUN-148-96-36-SW4</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>PETRO-HUNT LLC, BISMARCK-ND Letter of Permission: Access to School Land – Temporary Surface Frac Water Pipeline RW0008075 A – Common Schools MCK-153-95-16-NW4, SW4 LESS PATENTED ACRES</p>
<p>Granted to: For the Purpose of: Right-of-Way Number: Trust : Legal Description:</p>	<p>STREAMLINE WATER SERVICES LLC, WATFORD CITY-ND Letter of Permission: Access to School Land – Temporary Surface Frac Water Pipeline RW0008078 A – Common Schools MCK-150-98-36-NW4, SE4, SW4</p>

The following letters of permission were issued to groups wishing to use school trust lands under the Board's policy for access to trust lands by organizations. Fees may be charged for this use.

Granted to:	US FISH & WILDLIFE SERVICE, BISMARCK-ND
For the Purpose of:	Letter of Permission: Access to School Land – Pollinator Research Study
Right-of-Way Number:	RW0008076
Legal Description:	BRL-138-75-4-SE4NE4, LOT 1 (Trust A - Common Schools)
Legal Description:	BRL-141-76-36-SW4 (Trust A - Common Schools)
Legal Description:	BRL-141-80-14-NW4 (Trust E - Ellendale)
Legal Description:	BRL-142-78-36-SW4 (Trust A - Common Schools)
Legal Description:	EMM-27-135-75-NE4 (Trust A - Common Schools)
Legal Description:	EMM-36-136-78-NW4 (Trust A - Common Schools)
Legal Description:	KID-137-71-16-SW4 (Trust A - Common Schools)
Legal Description:	KID-140-73-6-SE4 LESS DEEDED ACRES (Trust A - Common Schools)
Legal Description:	SHE-147-78-19-SE4SE4 (Trust U - University of ND)
Legal Description:	SHE-148-78-14-S2S2 (Trust I - ND Industrial School)

A D J O U R N

There being no further business, the meeting was adjourned at 11:09 AM.

Doug Burgum, Chairman
Board of University and School Lands

Lance D. Gaebe, Secretary
Board of University and School Lands